

**REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL  
LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND  
PERFORMANCE INFORMATION OF OKHAHLAMBA MUNICIPALITY FOR THE YEAR  
ENDED 30 JUNE 2008**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Okhahlamba Municipality which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
  - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
  - selecting and applying appropriate accounting policies
  - making accounting estimates that are reasonable in the circumstances.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
6. An audit also includes evaluating the:
  - appropriateness of accounting policies used
  - reasonableness of accounting estimates made by management
  - overall presentation of the financial statements.

7. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Okhahlamba Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.
8. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis of accounting**

9. The municipality's policy is to prepare financial statements on the basis of accounting determined by the National Treasury, as set out in accounting policy note 1.

#### **Basis for adverse opinion**

##### **Property, plant and equipment**

10. The following deficiencies were identified in the management of the municipality's fixed assets:

- Assets amounting to R1,5 million could not be physical located.
- Certain material assets selected from the floor were not recorded in the asset register.
- Professional fees for integrated development and local development plans amounting to R558 285, incorrectly capitalised in the 2006-07 year still appeared in the asset register resulting in assets and accumulated surplus being understated.

Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness and valuation of assets amounting to R23,5 million.

#### **Provisions**

11. The landfill site operated by the municipality was scheduled to be closed during the 2008-09 financial year. However, the costs attributable to the closure of this site have not been calculated and accounted for as a provision in the financial statements. As a consequence, liabilities are understated and accumulated surplus is overstated by an unquantifiable amount.

#### **Receivables**

12. An amount of R410 138 for clinic subsidies reflected as debtors under other debtors was included twice in the sundry debtors balance. This has resulted in debtors and accumulated surplus being overstated. Had the amount not been duplicated, the accumulated surplus and debtors would have been reduced by R410 138.
13. In addition, included in debtors was an amount of R120 543 owing by Uthukela District Municipality as at 30 June 2008. However, the financial statements of the district municipality reflected a debit balance of R702 078, resulting in an unexplained difference of R822 621.

## **Revenue**

14. Complete rates reconciliation was not provided for audit purposes and there were also no satisfactory audit procedures that I could perform to obtain reasonable assurance that rate assessments were properly recorded as rates were not levied on certain properties. Consequently, I was unable to satisfy myself as to the completeness and accuracy of the rates assessment amounting to R4,2 million.
15. In terms of the paragraph 43 of the Standards of Generally Accepted Municipal Accounting Practice, GAMAP 9, *Revenue*, government grants are recognised as revenue when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity, the amount of the revenue can be measured reliably, and to the extent that there has been compliance with any restrictions associated with the grant. However, it was noted that an amount of R2,19 million for equitable share relating to the prior year was not recognised as revenue in the prior year although all the conditions as per paragraph 43 were met in the prior year. The amount was only recognised as revenue during the 2007-08 financial year resulting in revenue and government reserves being misstated.

## **Post-employment benefits**

16. Post-employment medical aid benefits were not recognised and disclosed as required in terms of South African Statements of Generally Accepted Accounting Practice, paragraphs 52 and 120A of IAS 19 (AC 116), *Employee benefits*. As a consequence, liabilities are understated and accumulated surplus is overstated by an unquantifiable amount.

## **Value-added tax (VAT)**

17. VAT on expenditure made from reserve accounts relating to assets amounting to R252 960 was incorrectly allocated to the reserve accounts resulting in the balance for reserves and VAT being understated. In addition, VAT on expenditure amounting to R312 963 was claimed twice resulting in VAT and expenditure being overstated.
18. Input VAT of R1 million claimed from the South African Revenue Service was not recorded on the general ledger and could therefore not be substantiated. Furthermore, output VAT of R2,6 million was incorrectly included in the VAT balance at year end. As a result, the VAT is misstated by R1,6 million.

## **Adverse opinion**

19. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, the financial statements do not present fairly, in all material respects, the financial position of the Okhahlamba Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended, in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the MFMA and DoRA.

## **OTHER MATTERS**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### **Internal controls**

20. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root

causes that gave rise to the inefficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Property, plant and equipment			✓		
Provision			✓		
Receivables			✓		
Revenue		✓	✓		
Post employment benefits			✓		
Value-added tax			✓		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: support all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

## Non-compliance with applicable legislation

### Municipal Finance Management Act

21. The 2007-08 budget time schedule outlining key deadlines was not tabled in the council nine months before the start of the financial year, as required by section 21(1) of the MFMA.
22. The contract entered into with the current municipal security provider was not entered into in writing as required by section 116 (a) of the MFMA.
23. The municipality entered into a public-private partnership during the year but did not comply with the requirements of section 120 as no feasibility study was completed and it could not be demonstrated that the partnership would provide value for money for the municipality.

## **Municipal Systems Act (MSA)**

24. A tariff policy on the levying of fees for municipal services was not adopted and implemented as required by section 74 of the MSA.

25. A credit control and debt collection policy was not adopted and implemented by the municipality as required by sections 96 and 97 of the MSA.

## **Matters of governance**

26. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

<b>Matter of governance</b>	<b>Yes</b>	<b>No</b>
<b>Audit committee</b>		
• The municipality had an audit committee in operation throughout the financial year.		✓
• The audit committee operates in accordance with approved, written terms of reference.	✓	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.		✓
<b>Internal audit</b>		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.	✓	
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
<b>Other matters of governance</b>		
• The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).		✓
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for auditing were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management.		✓
• The prior year's external audit recommendations have been substantially implemented.		✓
<b>Implementation of Standards of Generally Recognised Accounting Practice (GRAP)</b>		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		✓
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		✓
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		✓

## **Unaudited supplementary schedules**

27. The municipality provided supplementary information in the financial statements on whether resources were obtained and used in accordance with the legally adopted budget, in accordance with GRAP 1, *Presentation of Financial Statements*. The supplementary budget information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. Accordingly, I do not express an opinion thereon.
28. The supplementary information set out on pages xx to xx do not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

## **OTHER REPORTING RESPONSIBILITIES**

### **REPORT ON PERFORMANCE INFORMATION**

29. I was engaged to review the performance information.

#### **Responsibility of the accounting officer for the performance information**

30. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

#### **Responsibility of the Auditor-General**

31. I conducted my engagement in accordance with section 13 of the PAA read with General Notice 616 of 2008, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
32. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
33. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

## **Audit findings (performance information)**

### **Non-compliance with regulatory requirements**

#### **Performance information not received on time**

34. The financial statements submitted for auditing did not include a report on the performance information of the municipality, as required by General Notice 616, published in *Government Gazette No. 31057 dated 15 May 2008*; read with section 46 of the MSA.

#### **Existence and functioning of a performance audit committee**

35. The Okhahlamba Municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.

#### **Internal auditing of performance measurements**

36. The Okhahlamba Municipality did not develop and implement mechanisms, systems, and processes for auditing the results of performance measurement as part of its internal audit processes, as required in term of section 45 of the MSA.

## **APPRECIATION**

37. The assistance rendered by the staff of the Okhahlamba Municipality during the audit is sincerely appreciated.

Pietermaritzburg

09 January 2009



A U D I T O R - G E N E R A L